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IN THE

Supreme Court of the United States

OCTOBER TERM 1982

SOLITRON DEVICES, INC., BENJAMIN FRIEDMAN, JAMES S. TRAEGER and JAMES P. BARRY,

Petitioners,

—against—

HOWARD SIROTA and FAMILY RESTORATIONS, a Partnership, on behalf of themselves and all others similarly situated,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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In the

Supreme Court of the United States

October Term 1982

No. 81-2367

Solitron Devices, Inc., Benjamin Friedman, James S. Traeger and James P. Barry,

Petitioners,

—against—

Howard Sibota and Family Restorations, a Partnership, on behalf of themselves and all others similarly situated,

Respondents.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

In this securities class action brought on behalf of open market purchasers of stock of Solitron Devices, Inc., plaintiffs (respondents here) oppose the petition for a writ of certiorari, brought by defendants (petitioners here).

After a two week trial, the jury in this case found that the defendants had committed fraud. During 1967-70, Solitron announced to the public that its profits for 1967, 1968 and 1970 had increased by leaps and bounds. When the government attempted to recover Solitron's excess profits on government business, pursuant to the Renegotiation Act of 1951, Solitron admitted that its profits had been grossly overstated so that there were no excess profits to recover. The individual defendants, officers and directors of Solitron, actually knew of the income overstatements. Class

members were damaged when they purchased Solitron stock at prices inflated by Solitron's phony earnings (7a-9a).

Alleged Questions Presented for Review

There are no proper questions presented for review here. Defendants' alleged "questions presented for review" are not fairly presented by the record. Defendants seek certiorari with respect to:

> (i) the district court's alleged failure to conduct an inquiry into "the facts of the typicality of plaintiffs' individual claims";
>
> (ii) the district court's failure to decertify the class because the claims of individual plaintiffs were allegedly "never typical of the class"; and
>
> (iii) the use of expert testimony when allegedly "objective market facts [were] . . . directly contradictory."

As demonstrated below (i) the district court conducted a full inquiry into the facts of the typicality of plaintiffs' individual claims, (ii) the claims of the individual plaintiffs were typical of the class as of the time of certification, and (iii) there was never any disclosure that earnings for 1967 and 1968 were overstated during the period that those earnings primarily impacted upon the price of Solitron stock, so that there were no market facts to contradict the testimony of plaintiffs' expert.

Statement of the Case

Certification

The District Court's certification of the class came only after extensive hearings on the qualifications of the class representatives. Hearings were held on May 12, 1976, at

which time the motion for class action certification was held in abeyance pending further pre-trial discovery (81a); on July 22, 1976, at which time the motion was referred to a magistrate to schedule and supervise further pre-trial discovery bearing upon the delineation of the proposed class or classes and to hear and report with respect to the pending motion to declare a class (82a); and on October 26, 1978. (68a) There were various other hearings before the District Judge. (69a)

As a result of these hearings, the District Judge disqualified two purported class representatives because their purchases and/or sales were outside the parameters of the class period. (75a) He rejected attacks upon the remaining class representatives for alleged lack of typicality. (76a-77a)

The court did not determine *on the merits* whether the class period alleged properly ended on December 14, 1970, as defendants contended, when Solitron announced a writedown of inventory in the amount of $7 million attributed to depressed industry wide conditions, or at a later date, as plaintiffs urged. Plaintiffs claimed that the announcement of the writedown was itself fraudulent because the writedown was in fact not $7 million but was eventually revealed to be $10 million and the overstatements of earnings for prior years was not disclosed.

Refusal to Decertify

After the trial of this action, but before the case went to the jury, the parties stipulated that December 16, 1970 was the closing date of the class period. That date was prior to the purchases of Solitron stock by the named plaintiffs here. The jury, unaware of the stipulation delineating the class period, returned a general verdict for plaintiffs for a class period ending on June 2, 1971, a date

beyond the December 14, 1970 release and within which period plaintiffs purchased Solitron stock. As the Court of Appeals stated:

> "But for the parties' stipulation to December 16, 1970 as the closing date, the question of the effect of the press release (and thus the question of the merit of the named plaintiffs' claims) would have been resolved by the jury verdict." * (14a)

The District Court refused to decertify the class, although the named class representatives by stipulation would not recover on their claims.

Damages

On the question of damages, plaintiffs' expert witness testified that the overstated earnings gave a false picture of growth which caused the market place to overprice Solitron's stock by specified percentages for 1967, 1968 and 1970. The jury found for the plaintiffs but reduced the percentages to which plaintiffs' expert testified. (22a)

The Court of Appeals pointed out that there had never been any disclosure of lower earnings in 1967 and 1968 so that what the price of the stock would have sold at in those years if the true earnings had been disclosed was necessarily a hypothetical construct. (23a) For 1970, however, the Court of Appeals remanded for a recalculation of damages taking into account the actual decline in the price of Solitron stock when the December 14, 1970 announcement was made as well as other factors which may

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* Plaintiffs agreed to the stipulation of the earlier date just prior to the case going to the jury and during the drafting of the Special Interrogatories only to remove one controversy from the case—the damages sustained by those who purchased Solitron Stock between December 16, 1970 and June 2, 1971. (53a)

have affected the market's reaction to the announcement. (23a)

REASONS WHY THE WRIT SHOULD BE DENIED

I.

The Decision of the Court of Appeals That a Hearing on the Merits Prior to Class Certification Is Improper Does Not Conflict With Other Decisions and Follows *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974).

No Conflict Exists

Knowing that this Court gives importance to the existence of conflict among the circuits, petitioners have carefully crafted their petition in an effort to create an issue worthy of consideration by this Court—a purported conflict between the decision by the Second Circuit here and the decisions of other circuits. No such conflict exists.

The Court of Appeals here first held that precertification inquiry into the merits of a suit was barred by *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156, 177 (1974). "On the other hand," the Court of Appeals continued, "there can be no doubt that it is proper for a district court, prior to certification of a class to allow discovery and to conduct hearings to determine whether the prerequisites of Rule 23 are satisfied." The Court of Appeals then stated the following:

> "Indeed a district court may be reversed for premature certification if it failed to develop a sufficient evidentiary record from which to conclude that the requirements of numerosity, typicality, commonality of question and adequacy of representation have been met ..." (11a)

On the above point the Court of Appeals cited cases on which the petitioners heavily rely (*Doctor* v. *Seaboard Coast Line R. Co.*, 540 F.2d 699, 4th Cir. 1976; *Huff* v. *N.D. Case Company of Alabama*, 485 F.2d 710, 5th Cir. 1973; *In re LTV Securities Litigation*, 88 F.R.D. 134, N.D. Tex. 1980) in support of its decision, hardly the material on which to build a claim of conflicts among circuits.

No Important Issue of Federal Law Is Present

To determine whether the press release of December 14, 1970 revealed the truth sufficiently to overcome the effect of the fraudulent financial statements previously issued by Solitron, would have required the District Court to determine the merits, among other things, of plaintiffs' allegations of overstatement of inventory and consignments improperly classified as sales, defendants' claim as to the reason for the writedown (an alleged "drastic recession in the electronics industry"), and the impact upon the market price of Solitron's stock of the 1967, 1968 and 1970 overstatements and the December 14, 1970 press release. Indeed, what would have been involved was nothing less than a consideration on the merits of practically all of the issues in the case, an inquiry proscribed by this court in *Eisen*.

Here, the closing period of the class was fixed not by operation of the press release as petitioners urge, but by a stipulation entered into by all counsel at the end of the trial and before submission of the case to the jury. Plaintiffs' purpose in entering into this stipulation was in order to remove one issue from the case (the entitlement to damages of purchasers of Solitron stock in the Period between December 16, 1970 and June 2, 1971).

In a further effort to bolster their claim that an issue exists worthy of this Court's consideration, petitioners as-

sert that unlike the situation in *In re LTV Securities Litigation, supra, Piel* v. *National Semi-Conductor Corp.*, 86 F.R.D. 357 (E.D. Pa. 1980), and the other cases cited in page 13 of their petition, "Here, the District Court refused to inquire into defendants' claim that plaintiffs were not proper representatives of the class." Defendants' assertion is false. As we have already indicated, the District Court inquired into *all* of defendants' claims that plaintiffs were not proper representatives of the class. It refused to resolve on the merits only the issue of whether the December 14, 1970 press release closed the class period because such a resolution would have embarked the Court upon an improper inquiry.

Of course, the District Court here allowed the discovery and conducted the hearings, referred to by the Court of Appeals, "to determine whether the prerequisites of Rule 23 [were] satisfied."

II.

The Decision of the Court of Appeals That Decertification of the Class Is Not Required When the Class Representatives Do Not Recover on Their Individual Claims Dealt With No Significant Unsettled Question of Federal Law Nor Is It in Conflict With the Decisions in Any Other Federal Circuits.

Petitioners assert that the refusal of the District Court to decertify the class nullified the effectiveness of F.R. Civ. P. 23(c). In support of this grave assertion, petitioners state that the District Court "admitted that its certification of Sirota and Family Restoration as class representatives was improper." (Pet. Br. p. 15). Of course, the District Court made no such admission in any context in which plaintiffs could properly have challenged

it. Petitioners base their assertion on an utterance made in the course of a colloquy that "if hindsight were foresight they shouldn't have been designated as class representatives *because of the dates*" (emphasis added). But the dates were the result of a stipulation of counsel at the conclusion of trial in 1980 and could not have been the basis of a refusal to designate the plaintiffs back in February, 1979. Many comments are made in the course of colloquy which do not and should not have the force of a finding or a decision. Yet here we have an effort to elevate a remark in the course of colloquy to a level of importance it does not deserve.

The Court's considered judgment is found in its later Memorandum denying the defendants' motions for judgment notwithstanding the verdict or for a new trial where it noted that:

> The Court adheres to its earlier decision and finds that the class was properly certified on Febru[illegible] 14, 1979. . . . (55a)

It went on to say, with regard to defendants' motion for decertification:

> The class was certified prior to trial, the class claims were tried to the jury and the class members had an interest adverse to the defendants. I do not conclude that any benefit would result from a dismissal at the close of the trial, simply because the proof at trial demonstrated that the individual claims of the class representatives were barred. (55a)

The Court of Appeals agreed with the District Court with regard both to the initial certification and the denial of the request for decertification. It found that the initial certification was proper and found that, but for the stipu-

lation of the parties fixing an earlier termination date for the class period, the question of the effect of the press release would have been resolved against the position of the defendants by the jury verdict. "Thus, the subsequent definition of the class to exclude the individual named plaintiffs did not require decertification of the class." (14a) See also *Sledge* v. *J.P. Stevens & Co. Inc.*, 585 F.2d 625, 634 (4th Cir. 1978), *cert. denied*, 440 U.S. 981 (1979), where the Court stated: "The failure of the personal claims of the class representatives does not debar the previously certified Rule 23(b)(2) class."

Petitioners have not cited a single case which supports the proposition that a district court abuses its discretion by refusing to decertify when, after its initial certification, it appeared that plaintiffs lacked a meritorious individual cause of action. Nor is there any merit to their claim of a conflict among the circuits on this question, as an analysis of the cases cited by petitioners reveals.

In *Stastny* v. *Southern Bell Tel. & Tel. Co.*, 628 F.2d 267 (4th Cir. 1980), the Court decertified the class, not because of the plaintiff's inadequacy as a representative of the class, but because there were insufficient commonality of the issues in the case to warrant class action treatment. In *Scott* v. *University of Delaware*, 601 F.2d 76 (3rd Cir.), *cert. denied*, 444 U.S. 931 (1979), the plaintiff never claimed he was discriminated against and, in addition, failed to satisfy the numerosity requirement for class certification. Similarly, in *McLendon* v. *M. David Lowe Personal Service, Inc.*, 83 F.R.D. 204, 206 (S.D. Tex. 1979), the Court found that the "record contains no indication that numerous such people exist or the probability of others who may become class members in the future." Thus, there was a failure to meet the numerosity requirement.

The situation in the instant case is similar to that in *East Texas Motor Freight System, Inc.* v. *Rodriquez*, 431 U.S. 395, 406 n.12 (1977):

> "provided the initial certification was proper . . . the claims of the class members would not need to be mooted or destroyed because subsequent events or the proof at trial has undermined the named plaintiffs' individual claims."

The Court of Appeals in the instant case further explained why decertification was improper:

> "Here certification was proper, and there was no need for decertification . . . But for the parties' stipulation to December 16, 1970 as the closing date, the question of the effect of the press release (and thus the question of the merit of the named plaintiffs' claims) would have been resolved by the jury verdict. The defendants have not shown that the named plaintiffs failed to represent the class adequately, and the class victory before the jury might be thought to rebut such an argument in any case. Thus the subsequent definition of the class to exclude the individual named plaintiffs did not require decertification of the class."

III.

For Defrauded Buyers, Damages in 10b-5 Cases Are Calculated as of the Date of Purchase. There Is No Important Federal Question Upon Which the Lower Courts Disagree.

There is no confusion and uncertainty in the decisions of the lower courts concerning the date as of which damages should be measured. This court has stated the following in *Affiliated Ute Citizens* v. *U.S.*, 406 U.S. 128, 155 (1972):

> "In our view the correct measure of damages [in 10b-5 actions] is the difference between the fair value of all that the [defrauded] seller received and the fair value of what he would have received had there been no fraudulent conduct, see *Myzel* v. *Fields*, 386 F.2d 718, 748 (8th Cir. 1967), *cert. denied*, 390 U.S. 951 (1968)"

A buyer's measure of damages, as here, would be the converse—the difference between what the buyer paid and what he would have paid if there had been no fraudulent conduct, i.e. inflation of the price of Solitron's stock by overstated earnings.

The *Myzel* court, supra, at page 745, indicated that the fair value of the security should be measured on the date of the questionable transaction. Practically all authorities agree. See overwhelming authorities in accord, cited in Jacobs, *The Impact of Rule 10b-5* Vol. 5B, Sec. 260-03[c][ii] at 11-26, and at n.12 (Revised Edition 1980).

The reaction of the market to disclosure of the facts alleged to be fraudulent could, under certain circumstances, be *evidence* of what the true value of the stock was as of

the date of its purchase, prior to disclosure. Even this market reaction would be probative only if there was no intervening event affecting market values and no extraneous market forces were at work. "In short, the equation is apt if market movements after the date of purchase reflect only the outcome of factors existing at that date plus the effect of the correction of the fraud." *Jacobs,* supra, Sec. 260.03 (i)(ii), at 11-116.

Obviously the greater the time lapse between the period of fraud and the disclosure of that fraud, the more likely is it that intervening events and market forces will affect the price of the stock at the time of the disclosure, and the less reliable is the market's reaction to the disclosure as revealing what the true price of the stock would have been had there been no fraudulent conduct originally.

Here, the Court of Appeals, in remanding for calculation of 1970 damages, has indicated that the market's reaction to the press release of December 14, 1970 as well as other factors affecting the price of the stock, should be taken into account in fixing damages for 1970. For 1967 and 1968, there was never any interruption of those years' overstated figures by lower corrected figures, no market reaction thereto, and hence no necessity for remand.

Under such circumstances, as the Court of Appeals observed, the calculations of damages necessarily were "hypothetical constructs." Since there was no disclosure of the overstated earnings during the period of time those earnings impacted upon the market price of Solitron's stock, expert testimony was required to establish what the price of the stock would have been had the correct earnings been announced at the time. Of course, even with respect to 1970 earnings, this is not a *res ipsa loquitur* case. Expert testimony may be used to explain the market's reaction to the press release of December 14, 1970.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari to the United States Court of Appeals for the Second Circuit should be denied.

Respectfully submitted,

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